COMMONWEALTH OF KENTUCKY
BOARD OF TAX APPEALS
FILE NO. K13-R-18

WORLD ACCEPTANCE CORPORATION AND
WORLD FINANCE CORPORATION KENTUCKY **APPELLANTS**

v. **ORDER NO. K-24682**

FINANCE AND ADMINISTRATION CABINET
DEPARTMENT OF REVENUE **APPELLEE**

This appeal was presented by the parties on cross-motions for summary disposition. The case was fully briefed and an oral argument was held March 25, 2014 before the full Board. The Board enters the following conclusions of law.

BACKGROUND

This is a refund case concerning overpayments of corporation income taxes for the years ending March 31, 2007 through March 31, 2010, totaling $1,356,714.00 with applicable interest. The question presented is whether World Acceptance Corporation **(“**WAC”) and its wholly-owned subsidiary World Finance Corporation Kentucky (“WFCKY”), are required by Kentucky law to file consolidated Kentucky corporation income tax returns for the periods in question.

The taxpayers requested a letter ruling anonymously on the issue of whether the parent company had nexus and should file consolidated returns with its subsidiary. (Joint Ex. B) The Department in a March 25, 2011 letter ruled that the parent company had nexus based upon the facts presented in the letter and should file consolidated returns. The Department wrote, “[p]lease

note that the above answers are based upon the information presented, and additional facts could change some or all of our answers." (Joint Ex. C) Based upon this letter ruling WAC filed amended tax returns, which reflected the overpayments, and it sought the refund which is the subject of this case. The Department subsequently denied the refund claim on the basis that facts presented in the request for letter ruling were materially different from the actual facts which were subsequently presented, and WAC was not actually an "includible corporation" within the meaning of the statute, that was entitled to file a consolidated return under the statutes. (Final ruling, Joint Ex. L)

As a preliminary issue, the taxpayers seek to bind the Department to its letter ruling and the Department argues that it is not bound by its prior letter ruling, because there are material facts that are different from those set forth in the letter request. Alternatively, the taxpayers make a statutory argument. The parties disagree as to the controlling statutory definition of "includible corporation." Under the statutes, if a common parent corporation is not an includible corporation, it cannot be part of an affiliated group, and if it is not part of an affiliated group, it cannot file a consolidated return. The Department argues that WAC is not an "includible corporation in an affiliated group" within the meaning of the statute KRS 141.200 (9)(e). The taxpayer argues that there is another statute, KRS 141.200 (9)(b)(1), which provides that if a common parent corporation meets the specified ownership requirements, it is an "includible corporation" and that statute is controlling instead. Finally, the parties disagree as to whether the Department has correctly applied the statutory definition of includible corporation, upon which it relies, if that is the controlling definitional provision.

STATUTORY LAW

KRS 141.200(10) sets forth the specific situations where a consolidated return must be filed. "Every corporation doing business in this state…shall, for each taxable year, file a separate return unless the corporation was, for any part of the taxable year: (b) a common parent corporation doing business in this state…"

KRS 141.200(9)(g) defines a consolidated return as a "Kentucky corporation income tax return filed by members of an affiliated group in accordance with this section."

KRS 141.200(9)(c) defines a common parent corporation as "the member of an affiliated group that meets the ownership requirement of paragraph (a) 1. or (b) 1. of this subsection."

KRS 141.200(9)(b) sets forth the definition of "affiliated group" as follows:

1. For taxable years beginning after December 31, 2006, "affiliated group" means one (1)or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation if:

a. The common parent owns directly stock meeting the requirements of subparagraph 2 of this paragraph in at least one (1) other includible corporation; and
b. Stock meeting the requirements of subparagraph 2. of this this paragraph in each of the includible corporations, excluding the common parent, is owned directly by one (1) or more of the other corporations.

2. The stock of any corporation meets the requirements of this paragraph if the stock encompasses at least eighty percent (80%) of the voting power of all classes of stock and has a value equal to at least eighty percent (80%) of the total value of the stock.

The taxpayer argues that the definition of "includible corporation" for common parent corporations appears in KRS 141.200(9)(b)1, as set forth above, and that it meets the common parent ownership requirements for affiliated groups and is therefore, an "includible corporation." The Department argues that there is an "includible corporation" definition, specifically set forth in KRS 141.200(9)(e), which applies instead, because it expressly provides that the definition is to be " used in subsections (9) to (14) of this section." KRS 141.200(9)(e) defines includible corporation as "any corporation that is doing business in this state except…

7. Any corporation that realizes a net operating loss whose Kentucky property, payroll, and sales factors pursuant to KRS 141.120(8) are de minimis;

8. Any corporation for which the sum of the property, payroll and sales factors described in KRS 141.120(8) is zero."

The Department argues that, WAC does not qualify as an "includible corporation" under either subsections 7 or 8 of this statute.

CONCLUSIONS OF LAW

The Board concludes that the Department of Revenue is not bound by its March 2011 letter ruling to the anonymous taxpayer. Both parties agree that if the actual facts materially differ from those set forth in the request for a ruling, the Department should not be bound. The request letter asked if "taken together or separately, would the employee activities in Kentucky and/or transactional arrangement of the management fee be considered more than de minimis?" (Joint Ex. C). The request did not provide the specific information that the management services provided by WAC would be performed out-of-state, nor did the letter explain that the employee(s) of WAC, who worked in Kentucky, also worked in other states, in addition to Kentucky. The Board concludes that the Department of Revenue is correct that these additional facts are material to and change the analysis of the original ruling, as will be further explained below, and the Department is not bound by this March 2011 ruling.

The Board further concludes that the statutory definition for the term "includible corporation," set forth in KRS 141.200(9)(e), which by its express terms, applies to sections (9) to (14), is a specific definitional provision that cannot be ignored and is controlling when analyzing whether a corporation is required to file a consolidated return. This definitional provision does not make an exception for common parent corporations.

The remaining question to be decided is whether under the facts as presented, WAC is excluded as an "includible corporation" under KRS 141.200(9)(e), either subsection 7 or 8. This matter has been presented as a summary disposition case, so there are no factual disputes. This Board must determine whether WAC's "Kentucky property, payroll and sales factor pursuant to KRS 141.120(8) are de minimis," or "whether WAC's sum of the property, payroll and sales factors described in KRS 141.120(8) is zero," as a matter of law.

Under subsection 7, any corporation that realizes a net operating loss whose Kentucky property, payroll and sales factor are de minimis, cannot be an "includible corporation." There is no factual dispute that the taxpayer realized a net operating loss. There is a question of law as to whether the property, payroll and sales factors were de minimis within the meaning of the statute.

The undisputed facts to be considered are as follows. WFCKY is a corporation with over seventy storefronts in Kentucky which provide consumer loan and tax preparation services. (Petition of Appeal), During the period in question, WAC, a South Carolina corporation, had only one employee performing services in Kentucky. (Joint Ex. P) This employee performed audit services and worked between 39 and 55 days in Kentucky during each of the years in question. (Joint Ex. M). This employee was a resident of Tennessee and she performed audit services for WAC in Tennessee as well. (Interrogatory 13) She received her assignments, schedules and payroll from the corporate headquarters in South Carolina. (Request for Production 6, Interrogatory 13) This employee used a car and a laptop when she worked in Kentucky. (Joint Ex. P, Joint Ex. N) The only sales that WAC had in Kentucky during the time period in question consisted of a management fee that WAC received from WFCKY each year to cover the cost of management, accounting, payroll and administrative activities that WAC

performs for its subsidiaries. (Joint Ex. P) These services were performed by WAC in South Carolina. (Request for Production 6 and Interrogatories 16)

WAC argues that it had more than a de minimis payroll, property and sales factor in Kentucky. This Board must look to additional statutes which specifically address how these factors are determined. KRS Section 141.120(8)(b) provides that:

> The payroll factor is a fraction, the numerator of which is the total amount paid or payable in this state during the tax period by the corporation for compensation, and the denominator of which is the total compensation paid or payable by the corporation everywhere during the tax period. Compensation is paid or payable in this state if:
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> 1. The individual's service is performed entirely within the state;
> 2. The individual's service is performed both within and without the state, but the service performed without the state is incidental to the individual's service within the state; or
> 3. Some of the service is performed in the state and the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the state, or the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state.

WAC had to have compensation "paid or payable in this state" in order for there to be a Kentucky numerator for the payroll factor. WAC argues that the compensation of the Kentucky auditor should have been included in the numerator of its payroll factor, because the auditor performed those services in Kentucky. The Department says this auditor performed some of her WAC job in Kentucky, but she spent the majority of her time performing non-incidental audit services for WAC in Tennessee where she lived and she was directed and controlled from WAC's South Carolina base of operation. The Department argues that when services are performed in more than one state during the year, the law does not allow the Kentucky portion of the services to be viewed in isolation and that the taxpayer has not met the requirements of the payroll factor—the payroll factor was not more than de minimis. The Board concludes that the

Department correctly applied the provisions of KRS 141.120(8)(b) and sourced all of the employee's compensation to Tennessee and the payroll factor numerator for Kentucky is zero.

As for the property factor, the Department argues that WAC has raised the issue of the property factor not being de minimis, too late in these proceedings and that the factor should be zero. This Board will not rule upon this timing issue, because even if WAC was not dilatory in raising the issue, the Board concludes that the property factor was de minimis. KRS 141.120(8)(a) provides as follows:

> The property factor is a fraction, the numerator of which is the average value of the corporation's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the corporation's real and tangible personal property owned or rented and used during the tax period.

With respect to the numerator of the property factor, 103 KAR 16:290, Section 5(2) provides:

> The value of mobile or movable property such as construction equipment, trucks or leased electronic equipment which is located within and without Kentucky during the taxable year shall be determined, for purposes of the numerator of the factor, on the basis of total time within the state during the taxable year. An automobile assigned to a traveling employee shall be included in the numerator of the factor of the state to which the employee's compensation is assigned under the payroll factor or in the numerator of the state in which the automobile is licensed.

Based upon the rules, the car used by the travelling WAC employee on the days she was in Kentucky, may not be allocated to Kentucky under the regulation. The payroll factor would assign the compensation to Tennessee and the car is registered in Tennessee. The movable laptop can only be included in the numerator of WAC's property factor for the days the employee was in Kentucky which were limited in number. The Department has calculated this number at page 9 of its brief and WAC has not argued that the property factor has been improperly calculated "at thousandths of one percent." (Appellants' brief, page 5) This Board concludes that the property factor is de minimis as well.

Finally, WAC claims that the management fee received from WFCKY would create a Kentucky sales factor because the management fee was necessitated by the Kentucky operations of WFCKY. KRS 141.120(8)(1) provides that the numerator for the sales factor in Kentucky is the total sales of the corporation in this state during the tax period. Subsection (8)(c)(3) provides:

> sales other than sales of tangible personal property, are in this state if the income-producing activity is performed in this state; or the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

In this case, the basis of the management fee was the accounting and administrative services, the vast majority of which had been performed by WAC in South Carolina. A greater proportion of the income-producing activity is performed out of state rather than in state. The Department correctly sourced the management fee to South Carolina under the statute and WAC had a zero sales factor.

The original anonymous letter ruling request did not disclose that most of the management services were performed outside of Kentucky or that the employee worked in another state. Both of these additional facts changed the sourcing of the payroll and sales factors and resulted in a different conclusion than that which the Department originally set forth in its letter. The Department correctly concluded, after receiving this additional information, that the Kentucky property, payroll and sales factors pursuant to KRS 141.129(8) are de minimis" and that WAC was not an includible corporation within the meaning of the statute and could not file a consolidated tax return in Kentucky. The Department's final ruling No. 2013-28 is upheld.

FINAL ORDER

This is a final and appealable order. All final orders of this agency shall be subject to judicial review in accordance with the provisions of KRS Chapter 13B. A party shall institute an appeal by filing a petition in the Circuit Court of venue, as provided in the agency's enabling statutes, within thirty (30) days after the final order of the agency is mailed or delivered by personal service. The Board's statute, KRS 131.370(1), provides that the Circuit Court of venue for any party aggrieved by any final order of the Kentucky Board of Tax Appeals, except on appeals from a county board of assessment appeals, is the Franklin Circuit Court or the Circuit Court of the county in which the party aggrieved resides or conducts his place of business. Copies of the petition shall be served by the petitioner upon the agency and all parties of record. The petition shall include the names and addresses of all parties to the proceeding and the agency involved, and a statement of the grounds on which the review is requested. The petition shall be accompanied by a copy of the final order.

A party may file a petition for judicial review only after the party has exhausted all administrative remedies available within the agency whose action is being challenged, and within any other agency authorized to exercise administrative review.

A petition for judicial review shall not automatically stay a final order pending the outcome of the review, unless:

(a) An automatic stay is provided by statute upon appeal or at any point in the administrative proceedings;

(b) A stay is permitted by the agency and granted upon request; or

(c) A stay is ordered by the Circuit Court of jurisdiction upon petition.

Within twenty (20) days after service of the petition of appeal, or within further time

allowed by the Circuit Court, the Kentucky Board of Tax Appeals shall transmit to the reviewing court the original or a certified copy of the official record of the proceeding under review in compliance with KRS 13B.140(3).

DATE OF ORDER
AND MAILING: August 29, 2014

KENTUCKY BOARD OF TAX APPEALS
FULL BOARD CONCURRING

Cecil Dunn
Chair